



In demand

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Internal collections teams and debt collection agencies are gearing up for anticipated rises in arrears, but are they really ready to cope with the volume? Heather Greig-Smith investigates

A recent white paper from Experian on how to survive the credit crunch calls into question the ability of the collections industry to cope with the debt turmoil predicted. It says most collections operations are "over exposed and under prepared, with systems and processes simply not ready to meet the new collections paradigm".

The debt crisis follows 15 years of stable economic conditions, which Experian says has meant a "a relatively benign collections environment, leading to limited investment and a focus on reducing costs and write-offs, rather than preparing the department for a dramatic growth in delinquent accounts".

Now that the era of cheap credit and easy lending is over, expecting lenders to rapidly expand their collections teams may be unrealistic – experienced staff are hard to find and new starters take time to train.

Chris Buckham is marketing director for Tallyman in Experian's Decision Analytics division. He points out that there are few collectors who remember these conditions and have worked through the last downturn.

Buckham says the received wisdom of working debts to 90 days before passing to a debt collection agency (DCA) may no longer apply. "There may be too much debt for your own collectors to operate efficiently." That means passing to DCAs earlier in the process when the people they're chasing may be customers creditors want to keep, so need careful handling.

Under pressure

Yet if the expected wave of consumer hardship and mounting arrears does materialise, will the DCAs themselves be able to take the strain?

Henry Mehta is head of billing and collections at Veolia Water Outsourcing (previously known as Thames Water Services). "I won't be taking on more people – what I might be doing is renegotiating contracts with DCAs," he says. "However, I have got concerns with that because DCAs are getting a little bit overloaded."

Mehta says he can re-phase projects to give staff more capacity and is also looking at new technology such as automated messaging and text services. Short-term implementations are an option for creditors struggling to increase capacity, though Buckham points out that there's only so much technology can do. "Time is not on the side of traditional lengthy software implementation projects that tie up valuable collections personnel for months on end."

Lender strategy

Most lenders *Credit Today* contacted refused to comment on their collections strategy. However, one says he is "very aware" of the credit crunch and squeeze on affordability and is "monitoring it very carefully". Others, such as MBNA, say they believe their lending strategies

are robust enough to limit the threat.

Ray Hugill, head of credit and fraud strategy at Bradford & Bingley, says most lenders have been gearing up for increasing arrears since late last year. The building society has just decided it will outsource a small tranche of mortgage arrears. These are going to an outsourcing company rather than DCA. However, Hugill says loans and credit card arrears are another matter. "The DCAs will see massive levels of business from them," he predicts.

As the work pressure is mounting, so is the regulatory scrutiny. Last month, the Office of Fair Trading warned 13 companies, including debt collection agencies and financial institutions, to take steps to improve their debt collection practices following a marked increase in consumer complaints.

The problems it identified included: chasing consumers for payment of debts they did not owe; failing to properly investigate disputed debts; failing to carry out sufficient accuracy checks on data received from creditor clients and/or credit reference agencies; contacting debtors at unreasonable times and intervals, threatening home visits when debts were disputed; and refusing to deal with or bypassing third party consumer representatives such as Citizens Advice Bureaux.

The companies have been given four weeks to respond and the OFT will consider taking action against any that fail to address the concerns raised, up to and including revoking their consumer credit licences.

David Philpott, OFT deputy director of consumer credit, warns: "It is unacceptable for debt collection businesses to engage in unfair practices and we will continue to take action where we find evidence of this." That means no leniency – never mind the fact that teams may be overloaded.

The Credit Services Association says the next 12 months will be interesting for the industry and the credit crunch will have a number of different impacts.

"On the one hand it will mean more debt may be sold earlier to reduce funding and operating costs for the credit grantor, helping to improve their bottom line. On the other hand, funds to buy new debt may become harder to raise and cost more. Collection will become harder from debtors with fewer options," says executive director Kurt Obermaier.

Mike Cleary, managing director of 1st Credit, says there has already been a slight increase in the volume of collections work, but the crunch has yet to really have an impact on the industry. "We have an expectation that might happen in the back half of this year – it needs to kick in a bit."

Debtor profile

Cleary adds that if the crunch bites in the way forecasted, there will be a certain profile of person affected – such as homeowners hit by rate rises. "It will present a different profile of person falling into arrears and will be a new experience for creditors. A potential outcome is that creditors' in-house collection departments would have to focus more on the new profile of debt and more readily outsource the traditional type of account that's gone into default."

He says the increase doesn't necessarily mean recruiting more people because if DCAs have sophisticated systems and processes they can use analytical systems to collect. "The fresher the debt is, the more those systems will work."

Rahul Basu, executive vice president for Firstsource Solutions Global Collections, says UK

lenders should review the successful recovery and collections strategies of the early 1990s recession and those of the US in the current downturn, as North America was hit by the credit crunch about nine months ahead of the UK.

"The key lesson from the US experience is that while there will be more debt, it is likely to be less collectable in the short-term. This will be compounded by the fact that many consumers are indebted to several creditors, all of which will be reviewing their strategies for increasing the level of funds collected – so there will be increased competition for consumers' cash," he predicts. "Creditors need to develop strategies to be first in line for their consumers' cash, and lower their thresholds for minimum payments or length of payment plans."

According to Buckham, the general consensus is this "isn't a short sharp correction" and it will take at least three years for the bad debt to work its way through the system.

Improving trace and collect returns

Regardless of whether or not arrears grow and collections teams feel the strain, it is worth taking a look at improving tracing processes. This is especially important given recent figures show that 16.8m people are opting out of the edited electoral roll – making them harder to trace.

According to TDX Group, many creditors despair at the low levels of returns that they achieve in contrast with the perceived amount of workload and cost incurred. It says they could improve their returns by 50 per cent, simply through the effective use of segmentation and data rather than using a standard process.

Its analysis shows that as many as 60 per cent of the accounts that unsuccessfully complete two collection placements actually fall into the gone away category. Identifying them enables debt collection agencies to successfully contact an additional 25 per cent of debtors. These debtors liquidate five times better than accounts that were living as stated, through the first two placements.

Once an account has been identified as gone away, appropriate action can then be taken to trace and collect the debt.

TDX suggests separating the trace and collect elements. "Our analysis shows that it is possible to find up to 50 per cent of gone away accounts using a combination of data services provided by the credit reference agencies. Once an account has been found, it can then be sent to a specialist agency for trace validation and collection resulting in commission rates being reduced by as much as 30 per cent – a major concern in today's environment."

Another key to success is agency allocation as the strategies they employ have a massive impact on the relative performance on different segments. "For example, we have on our books debt collection agencies that are more than twice as strong as their nearest competitor in consumer debt segments but fall short of their competitors in business debt segments. And at the next level of segmentation the differences are even more stark. One particular debt collection agency is up to 10 times better than its closest challenger on the most difficult gone away segments."

Mark Onyett, chief executive of TDX Group, says: "Trace and collect has long been a painful subject for many creditors, and our analysis shows that there is a need to tread carefully. There is significant additional value to be gained from these accounts, but only by those who identify them at an early stage and then continue to adopt the best strategy for collection."

Vox Pops

Denise Allan, *head of operational finance, Sky*

"We think we're relatively well placed if the consumer environment gets tougher. Not only does home entertainment become more valuable to people if they go out less, we're also able to save our customers money if they switch their broadband or phone service. While we continue to monitor conditions closely, we've no plans to change our debt processes at the moment."

Simon Baum, *director of credit and risk, Alliance and Leicester*

"Alliance and Leicester has retained a fairly large collections team in recent years anyway. The teams are multi-skilled in personal loans, mortgages etc so can work across the whole group. If we needed to we could use an agency, but at the moment we're able to cope perfectly well on the collections side."

Ray Hugill, *head of credit and fraud strategy, Bradford & Bingley*

"I think lenders would like to keep things in-house. If you keep staff in-house it is cheaper, things are dealt with in a more consistent manner and it's a better experience for the consumer. The issue is that many lenders will find it difficult to attract the additional personnel they're going to need."

